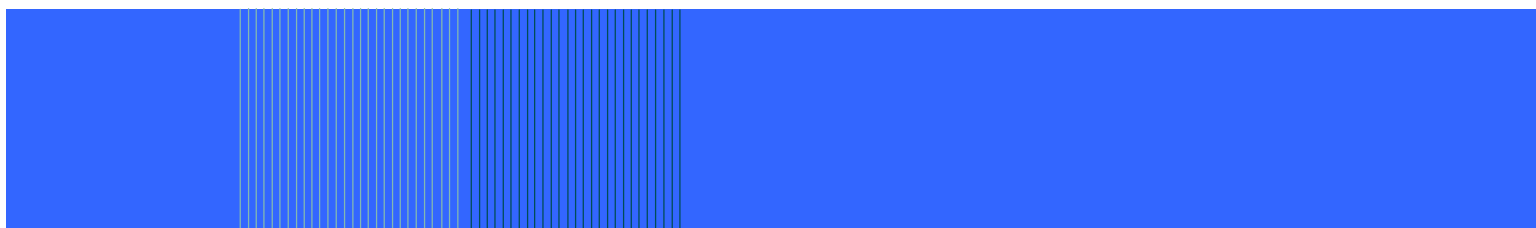


October 22, 2010

**The State of Minority- and Women-
Owned Business Enterprise: Evidence
from Minneapolis
PROGRAM RECOMMENDATIONS**

Prepared for the City of Minneapolis



NERA
Economic Consulting

**PRIVILEGED AND CONFIDENTIAL
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About the Project Team—NERA Economic Consulting

NERA Economic Consulting is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. We bring academic rigor, objectivity, and real world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

NERA's clients value our ability to apply and communicate state-of-the-art approaches clearly and convincingly, our commitment to deliver unbiased findings, and our reputation for quality and independence. Our clients rely on the integrity and skills of our unparalleled team of economists and other experts backed by the resources and reliability of one of the world's largest economic consultancies. With its main office in New York City, NERA serves clients from over 20 offices across North America, Europe, and Asia Pacific.

NERA's employment and labor experts advise clients on a wide range of issues both inside and outside the courtroom. We have provided expert testimony on statistical issues both at the class certification phase (on issues of commonality and typicality) and at the liability phase (for class or pattern-and-practice cases). Our experts have extensive experience examining issues of statistical liability in discrimination and other wrongful termination claims. We also provide detailed statistical analyses of workforce composition to identify potential disparities in hiring, layoffs, promotions, pay, and performance assessments and have conducted studies on labor union issues and on affirmative action programs for historically disadvantaged business enterprises.

NERA Vice President Dr. Jon Wainwright led the NERA project team for this Study. Dr. Wainwright heads NERA's disparity study practice and is a nationally recognized expert on business discrimination and affirmative action. He has authored books, papers, and numerous research studies on the subject, and has been repeatedly qualified to testify on these and other issues as an expert in state and federal courts. At NERA, Dr. Wainwright directs and conducts economic and statistical studies of discrimination for attorneys, corporations, governments, and non-profit organizations. He also directs and conducts research and provides clients with advice on adverse impact and economic damage matters arising from their hiring, performance assessment, compensation, promotion, termination, or contracting activities.

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Colette Holt & Associates is a Chicago-based law practice specializing in public sector affirmative action programs. The firm provides legal and consulting services to governments and businesses relating to procurement and contracting; employment discrimination; regulatory compliance; organizational change; program development, evaluation and implementation; and issues relating to inclusion, diversity and affirmative action. Colette Holt, J.D. is a nationally recognized expert in designing and implementing legally defensible affirmative action programs and is a frequent author and media commentator in this area. On this Study, Colette Holt served as legal counsel for NERA, providing advice and recommendations for the study's design and implementation, conducting interviews with business owners and state procurement officials, and drafting key study findings, among other duties.

J&D Data Services is a small business enterprise owned by Mr. Joe Deegan and based in Plano, Texas. After a long career with ScanTron, Mr. Deegan started his own business to offer a solid and proven alternative to the time consuming and expensive job of key data entry long associated with mail surveys. The firm helps its clients conserve their surveying resources by designing and delivering survey instruments that can be electronically and automatically scanned upon return and sent directly to electronic format. J&D Data Services has conducted numerous surveys of M/WBEs and non-M/WBEs on behalf of the NERA team. On this assignment they provided printing, postage, mail-out and mail-back service for the subcontract data collection, the mail survey, and the business owner interview invitations.

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The opinions expressed in this report are valid only for the purpose stated herein and as of the date of this report. No obligation is assumed to revise this report to reflect changes, events or conditions, which occur subsequent to the date hereof.

All decisions in connection with the implementation or use of advice or recommendations contained in this report are the sole responsibility of the City of Minneapolis. This report does not represent investment advice nor does it provide an opinion regarding the fairness of any transaction to any and all parties.

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I. Recommendations for a Revised Small and Underutilized Business Program

As detailed in this Report, we conducted a thorough examination of the evidence regarding the experiences of minority- and women-owned firms in Minneapolis' geographic and procurement marketplaces. As required by strict scrutiny, we have analyzed evidence of such firms' utilization by the City on its prime contracts and subcontracts, as well as M/WBEs' experiences in obtaining contracts in the public and private sectors. We gathered statistical data to provide the City with the evidence necessary to consider whether it has a compelling interest in remedying identified discrimination in its marketplace. We have further presented evidence relevant to the narrow tailoring of race- and gender-based remedies. Based upon our results, we make the following recommendations.

A. Augment Race- and Gender-Neutral Initiatives

1. Increase Vendor Communication and Outreach

Increased communication with the contracting community is critical. Minneapolis should undertake outreach efforts in addition to those conducted by the CERT Program for the local government consortium. Examples include conducting vendor outreach fairs, where M/WBEs and small firms can meet City contracting officials, learn about upcoming opportunities and network with prime vendors; making presentations to local M/WBE groups such as the National Association of Minority Contractors, the Women Construction Owners and Executives, minority chambers of commerce etc., to explain the Program and encourage participation and certification; and conducting seminars on how to do business with Minneapolis.

2. “Unbundle” Contracts

The size and complexity of the City's contracts may be a major impediment to M/WBEs and other small firms in obtaining work as prime contractors. In conjunction with reduced insurance and bonding requirements, smaller contracts should permit firms to move from quoting solely as subcontractors to bidding as prime contractors.

3. Adopt a Small Underutilized Business Target Market Program

The City should consider adopting a Small Underutilized Business Target Market Program, whereby smaller contracts with sufficient SBE, MBE and WBE availability would be set aside for bidding as prime firms only by certified businesses. This initiative will permit small firms to compete on a more level playing field with firms of comparable size, thereby somewhat equalizing some of the barriers faced by small firms to obtaining bonding, financing, access to networks, etc., without resort to race- and gender-based preferences.

A size- and location-based setaside will not be subject to the constitutional strictures of *Croson*, since business size and location are not suspect classifications subject to Equal Protection analysis. All that is required is that the ordinance has a “rational basis” and be permissible under state law to pass judicial muster. Given the judicial prohibition on race-based contract setasides,

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this is a critical race- and gender-neutral tool to provide opportunities for M/WBEs and other small firms to compete for prime contracts. Providing preferences to small firms on a race- and gender-neutral basis will also reduce the City's reliance on race- and gender-conscious subcontracting goals to meet the overall annual goals, as most M/WBEs are likely to qualify. This approach would further address the narrow tailoring requirement to reduce the burden on non-certified firms to the greatest feasible extent.

4. Collaborate with Other Local Agencies to Provide Supportive Services for Small Firms

A key race- and gender-neutral component is supportive services for small firms. These can include a mentor-protégé program for large City prime contractors and SBE, MBE and WBE subcontractors; a bonding and contract financing program for certified firms seeking work as prime contractors; assistance with preparing bids; accounting and legal services; marketing assistance; and other types of training. In view of resource constraints, it would be prudent to collaborate with other agencies to provide these types of services in a cost effective and comprehensive manner.

Finally, it is critical that race and sex data be collected on firms participating in programs. This will facilitate the next study, which should include review of the effectiveness of supportive services in remedying disparities on a race- and gender-neutral basis.

5. Appoint a Contracting Task Force

We suggest that Minneapolis develop a regular process for firms to “talk” to the City about concerns with the SUBP's policies, procedures and forms. This would be a valuable tool to elicit feedback from stakeholders and improve Program operations.

Members would be comprised of representatives from industry groups, business owners (of both certified and non-certified firms) and City SUBP, procurement and user department staff. Such a Task Force could meet monthly until consensus has been reached on broad measures, then less frequently as problems are redressed.

6. Improve Subcontract, Subconsultant, and Supplier Data Collection and Retention Procedures

The City's ability to track subcontractor, subconsultant, and supplier (“subcontractor” for short) activity remains limited, not only for non-M/WBEs but also for M/WBEs in many cases. It is important to understand that non-M/WBE subcontracting records are equally as important as M/WBE subcontracting records for purposes of evaluating contracting affirmative action at the level of detail specified by *Croson* and *Adarand*. This is because narrow tailoring requires the allocation of contracting and procurement dollars by industry category and it has been demonstrated that expenditures with M/WBE subcontractors are likely to be distributed differently across industry categories than expenditures with non-M/WBE subcontractors.

The most effective and least burdensome method to accomplish this additional data collection is to require prime contractors, consultants, and vendors to submit, either as part of their bid

packages or at some other point prior to the purchase or contract award, a standardized form listing all proposed first-tier subcontractors, including M/WBEs and non-M/WBEs. This form should clearly identify the prime contract/purchase order and prime contractor, consultant, or vendor, and should include, at a minimum, the following information:

- Unique prime contract/purchase order identification number or code for which the subcontract is related.
- Unique identification number or code for each subcontractor (regardless of subcontractor's M/WBE or certification status).
- Business address of subcontractor (street, city, state, zip code).
- Business area code and telephone number of subcontractor.
- Contact person at subcontractor (name, title, telephone, e-mail address).
- Original dollar amount of subcontractor award.
- Brief description of the nature/type of work of the subcontract.
- Cumulative dollar amount of all change orders to the subcontract.
- Indicator for whether or not subcontractor is a M/WBE (including certification status).
- If subcontractor is a M/WBE, indicator for primary race/sex of owner(s) (*i.e.*, African American, Asian/Pacific Islander, Hispanic, Native American, White female);
- Total dollar payments to subcontractor through contract completion date.

Additionally, the prime contractor, consultant, or vendor should be periodically required during contract performance to certify that no material changes have been made to the proposed roster of subcontractors or subcontract amounts. This could be done at each pay application or each calendar or fiscal quarter. If change orders have been issued to any subcontractors, if new subcontractors have been added, or if original subcontractors have been dropped, then this should be noted and the pertinent details provided. At the final pay application, the prime contractor should be required to certify the final amounts actually paid to each subcontractor.

All of the above data should be maintained for all contracts and purchases greater than \$50,000.¹ Beyond this, the City is strongly encouraged to consider working with its IT personnel or engage an outside consultant to develop methods to maintain this data electronically for general program management use and to fully integrate the Civil Rights Department's contract tracking into the rest of the City's finance and purchasing systems. The collected information can be integrated into existing data collection systems, or alternately, there are several specialized software products on the market designed to facilitate this process for public agencies.²

¹ This is the Informal Bid threshold. *See* City of Minneapolis Code of Ordinances, Chapter 139.20. *See also* Chapter 423.40.

² For additional information and tips on collecting and maintaining subcontract data, *see* Wainwright and Holt (2010), Appendix A.

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7. Monitor Contract Performance Compliance

Minneapolis currently does not actively monitor contractors' compliance with their commitments to utilize certified firms during the course of contract performance. Research for other jurisdictions strongly suggests that all too often, firms that are listed to meet goals are substituted or have the scope of their work reduced by the prime vendor after award. M/WBEs have also repeatedly reported problems with fair treatment and payment. Therefore, the City should require that prime contractors and consultants submit proof of their compliance with the terms of their contracts and provide for certified firms to confirm these representations. An electronic contract compliance system, which the City has already purchased, should be quickly implemented for this critical element of ensuring equal opportunities are the reality on Minneapolis projects.

In addition, the standards and processes for substituting subcontractors should be documented and publicized. Training to all parties to the process should be provided. Finally, where contractors have breached their agreements or otherwise violated Program rules, the City should consider the imposition of liquidated damages and debarment, as provided in the SUBP ordinance.

B. Adopt New Race- and Gender-Conscious Policies and Procedures

Based upon this Study, Minneapolis has a firm basis in evidence to implement a revised race- and gender-conscious Program. This record establishes that M/WBEs in the City's marketplace continue to experience significant disparities in their access to private and public sector contracts and to those factors necessary for business success, leading to the inference that discrimination is a significant cause of those disparities. The Study provides the statistical evidence to answer in the affirmative the question whether there is strong quantitative evidence that establishes the City's compelling interest in remedying race and gender discrimination, because absent government remedial intervention, it will be a passive participant in a discriminatory marketplace. There is ample evidence that Minneapolis can choose to intervene affirmatively to reduce racial and gender barriers to participation in its locally funded contracting opportunities. We make the following suggestions for revising the Small Underutilized Business Program (SUBP).

We note that disparities for all groups in almost all industries are substantively significant, and that the evidence for the wider economy of the possible presence of discrimination is extensive. It would be a mistake to interpret the lack of statistical significance (as opposed to substantive significance) in many of the categories in Tables 7.11 and 7.12 as a lack of adverse disparity. While tests for statistical significance are very useful for assessing whether chance can explain disparities that we observe, they do have important limitations. First, the fact that a disparity is not statistically significant does not mean that it *is* due to chance. It merely means that we cannot rule out chance. Second, there are circumstances under which tests for statistical significance are not helpful for distinguishing disparities due to chance from disparities due to other reasons (e.g., discrimination). In the particular statistical application presented in the Study the chance that a test for statistical significance will incorrectly attribute to chance disparities that are due to discrimination becomes greater when (a) we examine a relatively small number of procurements for example, of 1,555 contracts and subcontracts in Construction, only 23 involved African Americans), (b) the expected utilization of particular race/ethnic/gender groups-measured by

their availability—is relatively small, and (c) there are large variations in the relative dollar size of contracts and subcontracts.

We further note that the lack of complete subcontracting records required the use of sampling techniques, which may have affected the outcomes of the statistical significance testing. Analyzing all records would eliminate the need to sample, meaning that all results would be statistically significant because the entire universe would be included. In the future, the City should create and maintain the records that will eliminate the need to sample contracts.

Moreover, the City’s own data— which show large disparities even with the operation of the SUBP— may partially mask the effects of discrimination through the application of the remedy of affirmative action. In our view, the results in Chapter VII of the Study are most useful for examining the effectiveness of its SUBP policy during the study period. Those findings suggest that the Program has been somewhat effective but discrimination still impedes opportunities for M/WBEs on City prime contracts and subcontracts.

Turning to the narrow tailoring requirement, in general, we recommend that the City’s SUBP mirror the US Department of Transportation’s Disadvantaged Business Enterprise (“DBE”) Program, contained in 49 C.F.R. Part 26, to the greatest feasible extent. The criteria for eligibility and the implementing provisions of Part 26 have been unanimously upheld by the courts.

1. Adopt Narrowly Tailored Program Eligibility Standards

As generally outlined in the DBE program, a revised City program should require that eligible individuals must suffer both social and economic disadvantage. The Study establishes that the racial and ethnic groups studied and White women continue to suffer social disadvantage in seeking City prime contracts and subcontracts. We suggest that, like the DBE Program, persons who are not members of the presumptively disadvantaged groups established by the Study be permitted to prove on an individual basis that they have suffered the type of disadvantage sought to be remedied by the program.³

To ensure that only economically disadvantaged individuals participate in the new Program’s benefits, we recommend that Minneapolis adopt a personal net worth limit, excluding the owner’s equity in his or her principal residence and the firm seeking certification. The details could reflect the approach utilized in the DBE and Small Business Administration programs. Currently the limit on personal net worth is \$750,000, with retirement accounts discounted to present value less any penalties. Should the DBE program limit be raised, the City could follow suit.

In addition to these markers of the types of disadvantage sought to be ameliorated by the Program, firms should be small, that is, not exceeding the size standards set in 13 C.F.R. Part

³ See 49 C.F.R. Part 26, Appendix E, Individual Determinations of Social Disadvantage.

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121 or the Minnesota Department of Administration's small business size standards.⁴ Gross receipts could be averaged five years rather than three as in the DBE program, to provide more flexibility and time for M/WBEs to increase their capacities before competing in the overall, unremediated markets.

Finally, the firms should have their principal place of business in Minneapolis' market, established by the Study to be the Minneapolis-St. Paul-Bloomington, MN Metropolitan Statistical Area

2. Adopt Overall, Annual City M/WBE Goals

The Study's estimates of the availability of M/WBEs in Minneapolis' marketplace are provided in Chapter IV. These form the starting point for consideration of setting overall, annual targets for spending with M/WBEs. However, this snapshot of firms doing business in the City's geographic and procurement marketplace does not *per se* set the level of M/WBE utilization to which it should aspire. As discussed in Chapter V, current M/WBE availability is depressed by the effects of discrimination. A case can be made for setting a goal that reflects a discrimination-free marketplace rather than the results of a discrimination infected marketplace.⁵ Using the disparities in the business formation of M/WBEs compared to non-M/WBEs can provide a quantitative basis for such a determination. However, we do not recommend setting goals at the level that would be expected "but for" discrimination at this time, in view of the suspension of the prior program.

The Study provides current, detailed estimates of the availability of M/WBEs in the City's geographic and procurement marketplaces for construction, CRS, services, and commodities. These estimates can form the basis for setting Citywide and contract-specific goals for MBE and WBE utilization. These results are contained in Table 4.15 of the Study, reproduced below:

Table 4.15. Estimated Availability—Overall and By Procurement Category

Detailed Industry	African American	Hispanic	Asian	Native American	MBE	Non-minority Female	M/WBE	Non-M/WBE

⁴ We note that the Minnesota size standards vary widely from those of the US. Small Business Administration. For example, the SBA standard for masonry contractors is \$14.00 million/year; the MMD standard is \$22.9 million/year. We were unable to find information about how Minnesota determined its standards. <http://www.mmd.admin.state.mn.us/sicsize.asp>

⁵ See, e.g., 49 CFR §26.45(d) (DBE goal must reflect the recipient's "determination of the level of DBE participation you would expect absent the effects of discrimination").

Detailed Industry	African American	Hispanic	Asian	Native American	MBE	Non-minority Female	M/WBE	Non-M/WBE
CONSTRUCTION	2.54	3.96	1.37	0.91	8.78	10.72	19.50	80.50
CRS	2.16	1.98	3.16	0.64	7.95	11.18	19.13	80.87
SERVICES	4.59	3.44	3.27	0.61	11.91	15.62	27.52	72.48
COMMODITIES	3.93	3.54	3.28	0.72	11.47	14.05	25.53	74.47
TOTAL	3.08	3.72	2.02	0.82	9.63	12.09	21.73	78.27

Source: See Table 4.1.

Minneapolis should annually review its progress towards meeting the annual M/WBE goals. It should further determine whether race- and gender-conscious remedies continue to be necessary to meet the goals, or whether subcontracting goals should no longer be set for some types of contracts. However, there is no legal requirement to set new goals every year; indeed, there will not be new availability data until the next disparity study, and the Census Bureau conducts the *Survey of Business Owners* only every five years. Thus, the annual goals adopted based upon the current evidence should continue until full and accurate data are analyzed in a future study.

3. Set Contract Specific Goals Based on the Study

This Study's detailed industry and group availability estimates provide an objective starting point for contract goal setting. A contract goal should reflect the availability of firms to perform the anticipated scopes of the contract, weighted by the extent those scopes represent of the total contract price.

We also recommend that the minimum number of available M/WBEs be at least three to set a contract goal. This will ensure that there is adequate competition within the subcontracting industry sectors and reduce the burden on non-certified firms—a key component of narrow tailoring.

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We recommend that the City allow M/WBEs to count their own participation towards the contract goal. This permits the firms to grow and enhance their capabilities. It also mirrors the practice in the USDOT DBE program.⁶

To increase flexibility and recognize the often highly specialized nature of the City's contracts that may not allow for several areas of significant subcontracting, we suggest that Minneapolis permit contracting staff to aggregate the MBE and the WBE goal where appropriate. This type of approach has the benefit of also providing the type of flexibility and lessening of burdens on prime contractors that the judicial requirement of narrow tailoring favors.

Minneapolis should bid some contracts it determines have significant opportunities for M/WBE participation without MBE, WBE or SBE goals. These "control contracts" will illuminate whether M/WBEs are used or even solicited in the absence of goals. Such unremediated market data will be probative of whether the City still needs to implement M/WBE contract goals to level the playing field for its contracts.

4. Continue Policies and Procedures for Good Faith Efforts Reviews and Waivers of Contract Goals

The courts have categorically held that narrow tailoring requires that waivers of goals be available to a bidder that made good faith efforts. A bidder that made good faith efforts must also be treated the same as one that met the goals. To do otherwise- that is, to favor utilization above good faith efforts- will undoubtedly be held to be an impermissible race- and gender-based quota. That so few waivers were granted by the City of Chicago was a major cause of its M/WBE Program's constitutional infirmity. Uniform standards for demonstrating good faith efforts and documenting commercially useful function must be adopted, so that bidders and City staff have clear guidelines about when good faith efforts have been met.

One of the most developed aspects of the SUBP is the Standard Operating Procedure [for] Good Faith Efforts Review. We recommend the City review this Procedure and any documents provided to bidders or proposers, for conformance with the outlines of the good faith efforts provisions of 49 C.F.R. §26.53, to be used as a guide for standardizing and implementing good faith efforts. For example additional elements could include providing lists of certified firms in the NAICS codes used to set the contract goal with the invitation for bid or request for proposals; stating the minimum time for subcontractors to submit quotes or proposals; and the requirement that listed subcontractors, subconsultants and suppliers sign the utilization plan that describes their quote or scope of work and, if applicable, price.

5. Monitor Contract Performance and M/WBE Commitments

A critical element of Program integrity and success is the complete monitoring of prime contractors' commitments to utilize M/WBEs. Minneapolis currently does not monitor compliance during performance; contractors' utilization is reviewed at contract close out. This is

⁶ 49 C.F.R. § 26.55(a).

too late to correct any deficiencies and ensure that M/WBEs are treated fairly on the contract. After a contract with M/WBE commitments has been awarded, it is crucial that those commitments be monitored and that sanctions for non-conformance with the contract be available.

As previously discussed, the implementation of a comprehensive data tracking and monitoring system is a necessary element of a successful Program. It will also be necessary to have sufficient personnel to act upon the results of the tracking system. In addition, the standards and processes for substituting subcontractors should be documented and publicized. Training to all parties to the process should be provided. Finally, where contractors have breached their agreements or otherwise violated Program rules, the City should consider the imposition of liquidated damages and debarment.

6. Develop Performance Measures for Program Success

While recognizing the systemic barriers faced by minorities and women in competing for City contracts and subcontracts on a full and fair basis, developing quantitative performance measures for certified firms and overall Program success would provide measures for evaluating the Program. Possible benchmarks are the achievement of business development plans similar to those used in the Small Business Administration's 8(a) Program; revenue targets for certified firms; increased prime contracting by M/WBEs; and graduation rates. It will be important to track the progress of graduated firms to evaluate whether they succeed without the Program, and if not, why not. Further, data should be kept on requests for waivers of goals, to determine the accuracy of goal setting and areas for additional M/WBE outreach.

7. Mandate Program Review and Sunset

To meet the requirements of strict constitutional scrutiny, Minneapolis should require that the evidentiary basis for the Program be reviewed at least every five years, and that only if there is strong evidence of discrimination should it be reauthorized. The Program's goals and operations must also be evaluated to ensure that they remain narrowly tailored to current evidence. A sunset date for the Program, when it will end unless reauthorized, is required to meet the constitutional requirement of narrow tailoring that race-conscious measures be used only when necessary.

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